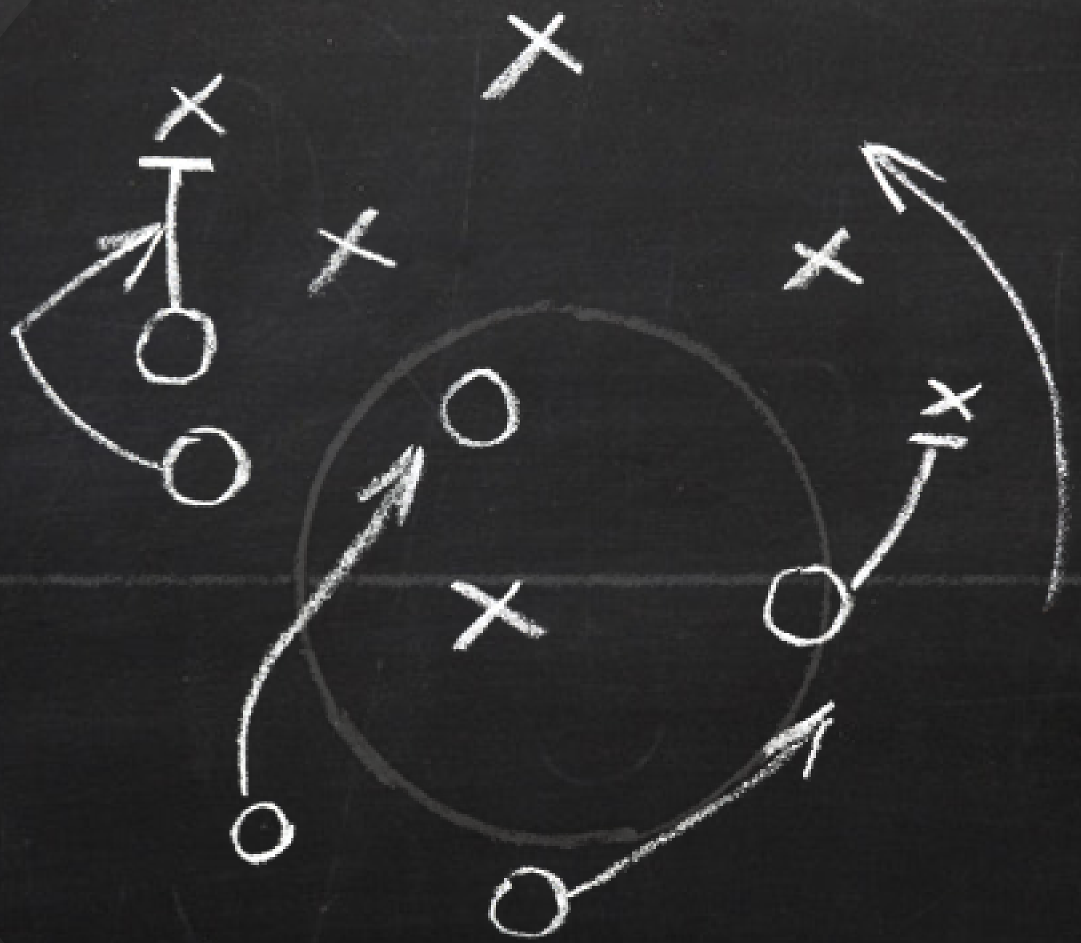
Insigneo Special
July 2022

English Version



NOTE FROM THE CIO

Monthly Update to the Insigneo-Forefront Recessionary Indicator

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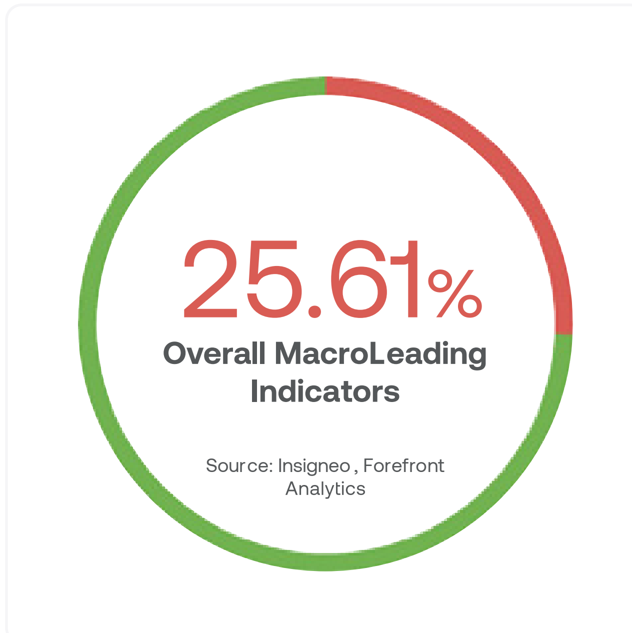
Monthly Update to the Insigneo-Forefront Recessionary Indicator



Our proprietary recessionary indicator which gives the probability of a US recession over the next 6 months has risen to approximately 26%, from under 10%.

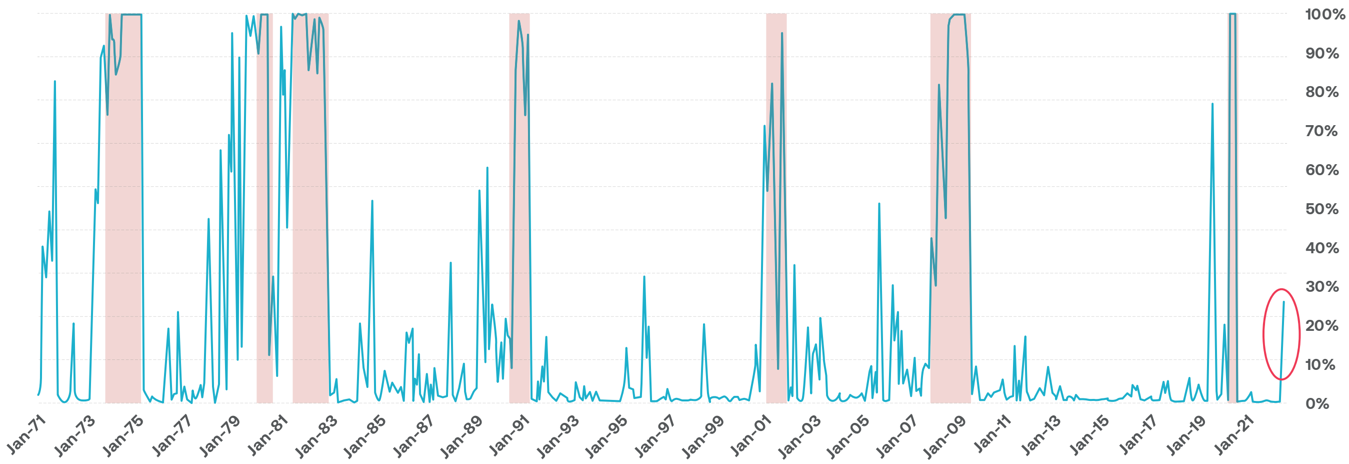
This is still below the 40% threshold level for a bearish tilt to our asset allocation models, and while growth risks are increasing our base case remains no recession and an acceleration in growth during the latter half of the year.

However, recessionary risks have risen as we discussed during our quarterly call where we subjectively placed the probability of a recession over the next *12 to 18 months* at around 40%. We now raise those closer to 50% due to the deteriorating reading from our indicator.

As mentioned, the risks stemming from a monetary

Forecasted Rexession Probability for 2-Quarter Forward Period using All Macro Leading Indicators

January 1971 - May 2022 | Source: Insigneo, Forefront Analytics (shaded areas indicate US NBER recessions)



policy mistake of overtightening have increased as the Fed has communicated to the market that they will not pivot until they observe several months of declining inflationary prints.

But inflationary figures like CPI, PPI, and PCE are lagging indicators. So, if the Fed waits to pause until those numbers turn lower, then monetary policy may already have turned too restrictive by that point.

The economy is already slowing down substantially as reflected in real-time activity data, but real-time and more timely inflationary data are also moderating.

As we write this, Fed Fund futures are signaling a terminal rate near 3.5% by the end of the year which is within our estimate of the economy's neutral rate of interest.

It is our view that any material increase in Fed Fund futures above current levels would likely tip the economy into a recession.

We would like to reiterate that, should a recession materialize, it would be much milder than the two most recent recessions caused by exogenous shocks (i.e., the GFC and the pandemic) since:
a) there are no major obvious imbalances in the economy or markets now that most financial assets have repriced substantially lower and both private, State, and corporate balance sheets remain robust, and
b) a Fed-induced recession could be mitigated by easing monetary policy. Indeed, those same Fed Fund futures mentioned previously are already pricing in a rate cut by July 2023.

— "Our proprietary recessionary indicator which gives the probability of a US recession over the next 6 months has risen to approximately 26%, from under 10%."

At this time, the change in our indicator is not sufficient to trigger a change in our risk-on/risk-off tilts in our asset allocation models.

We remain neutral risk assets given the market's poor performance thus far this year with tilts in Value-factor and high-dividend equities, Chinese equities, and geopolitical/inflationary hedges in commodities and gold.

Given that investors have already absorbed a meaningful portion of the median (-24%) and average (-30%) price declines for the S&P 500 during recession-linked bear markets dating back to World War II, there is no compelling reason for further de-risking of portfolios at the moment.

However, a recession would increase the time-frame for a financial market recovery from Q4 2022 (our current expectation) to Q1/Q2 2023. It would also create a tactical opportunity favoring Growth-factor equities, traditional safe-haven sovereign bonds, and safe-haven currencies like the US Dollar. ■

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